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EU JOINT TRANSFER PRICING FORUM

DISCUSSION PAPER ON DRAFT JTPF RECOMMENDATIONS RELATED TO INTEREST CHARGES IN THE CONTEXT OF MUTUAL AGREEMENT PROCEDURES

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1. Introduction

During its October 2007 meeting the JTPF discussed the issue of interest charges in the context of MAP. This discussion was based on Doc.JTPF/016/2007/EN and it was recognised that:

- MS interest provisions are part of the general administration rules governing the tax policy of a country;
- interest charges are not put in place to put a penalty on the taxpayer or to sanction a fault from the taxpayer;
- the length of time the AC or MAP procedure takes is largely due to the actions of the governments not the taxpayer;
- two periods for interest charged should be distinguished: one covering the period before the adjustment for which the tax administration is fully entitled to receive a compensation for late payment (the so called accrual of interests for late payment) the second one covering interests charged (or to be charged if the payment was suspended) during the MAP negotiations (where the taxpayer is requested to pay interest because the tax administrations try to determine between themselves where the tax should be paid). Our paper focuses on this second type of interest charges;
- As regards the possibility for the JTPF to adopt conclusions on such a topic, we must keep in mind that the recommendation from the JTPF to suspend tax collection was finally endorsed by the MS in the Council and subsequently implemented through administrative or legislative amendments. This new issue would require the same approach. It seems unduly harsh to suspend the tax but keep the interest charge running;
- The Forum recommendations would be based on chapter IV, 4.64 to 4.66 of the OECD Guidelines;

At the end of the discussion a consensus could be found that the Secretariat would prepare a paper following the second option: the problem would be illustrated through practical examples, the objective would be described (a taxpayer should not pay interest for the period where tax administrations discuss together), the different possibilities would be described (matching payment/reimbursement after the MAP, interest charges included in the MAP discussion, freezing of interest charges, other).

2. Basic examples

Case 1

			Interest 10% in State A	Interest 10% in State B
Tax return	1/1/2004		200' €	200' €
Tax adjustment	1/1/2006	1M €	100' €	100' €
MAP	1/1/2007		100' €	100' €

request			
MAP	1/1/2008		
agreement			
MAP	50%/50%		
results			

This example is based on the following basic assumptions:

Both tax returns are filled in on 1/1/2004

Both tax administrations apply an interest rate of 10% to tax adjustments and tax reimbursements MAP agreement is reached on dividing the tax adjustment by two.

In this particular case tax administrations have decided also to deal with interests previous to the MAP request.

Practical conclusions

Where MS have agreed to freeze interests for the period between the MAP request and the MAP agreement 300' € are to be considered and the taxpayer in State A will have to pay 300/2 and the taxpayer in State B will get a reimbursement of 300/2.

Where MS have agreed to charge interests for the period between the MAP request and the MAP agreement 400' € are to be considered and the taxpayer in State A will have to pay 400/2 and the taxpayer in State B will get a reimbursement of 400/2.

Where MS did not agree to consider interest as an issue the MNE group could pay up to 400' €of surcharges.

Case 2

			Interest 10% in State A	Interest 5% in State B
Tax return	1/1/2004		200′€	100′€
Tax	1/1/2006	1M €	100′€	50'€
adjustment				
MAP	1/1/2007		100′€	50'€
request				
MAP	1/1/2008			
agreement				
MAP	50%/50%			
results				

This example is based on the following basic assumptions:

Both tax returns are filled in on 1/1/2004

One tax administration applies an interest rate of 10% and the other tax administration applies a rate of 5%

MAP agreement is reached on dividing the tax adjustment by two.

In this particular case tax administrations have decided also to deal with interests previous to the MAP request.

Practical conclusions

Where MS have agreed to freeze interests for the period between the MAP request and the MAP agreement:

Adjustment made by A: the taxpayer will have to pay in A 300'€2 = 150'€ and will be reimbursed in B 150'€2 = 75'€ Surcharge for the Group: 75'€

Adjustment made by B: the taxpayer will have to pay in B 150'€2 = 75'€and will be reimbursed in A 300'€2 = 150'€ Profit for the Group: 75'€

Where MS have agreed to charge interests for the period between the MAP request and the MAP agreement

Adjustment made by A: the taxpayer will have to pay in A 400'€2 = 200'€ and will be reimbursed in B 200'€2 = 100'€ Surcharge for the Group: 100'€

Adjustment made by B: the taxpayer will have to pay in B 200'€2 = 100'€ and will be reimbursed in A 400'€2 = 200'€ Profit for the Group: 100'€

Where MS did not agree to consider interest as an issue the MNE group could pay up to 400' €of surcharges.

Conclusions from the cases:

There is a clear conclusion from these examples that for MNEs the issue of interest charges related to MAP can impact their cash flow. Secondly the absence of harmonization of the interest rates to be applied pleads in favour of the freezing option. Thirdly interest charges can represent an important amount as MAPs are generally long.

3. JTPF conclusions and recommendations

In its Guidelines on transfer pricing the OECD underlines in Chapter IV, 4.65 that

"Whether or not collection of the deficiency is suspended or partially suspended, other complications may arise. Because of the lengthy time period for processing many transfer pricing

cases, the interest due on a deficiency or, if a corresponding adjustment is allowed, on the overpayment of tax in the other country can equal or exceed the amount of the tax itself. <u>Tax administrations should be aware that inconsistent interest rules across the two jurisdictions may result in additional cost for the MNE group, or in other cases provide a benefit to the MNE group (e.g. where the interest paid in the country making the corresponding adjustment exceeds the interest imposed in the country making the primary adjustment) that would not have been available if the controlled transactions had been undertaken on an arm's length basis originally, and this should be taken into account in their mutual agreement proceedings".</u>

Based on the OECD considerations the JTPF recognizes that a taxpayer should not pay interests on Transfer Pricing adjustments for the period where tax administrations discuss together during a MAP. However as interest charges are part of the general administration rules governing the tax policy of a country and considering the subsidiary principle tax administrations are invited to choose one of the following options to tackle with this issue. These options prevail only to interests during the MAP negotiations.

Option 1:

When initiating the procedure the Competent authorities could agree that at the end of the procedures interests to be reimbursed to the company on its overpaid taxes by one tax administration, and the interest to be paid on its additional taxes by the other company to another tax administration would be matched.

Option 2:

When initiating the procedure the Competent authorities could agree to include interest charges (payments and refunds) in the MAP discussion itself. The outcome from the MAP discussions would include an unique amount composed of tax and interest to be paid or reimbursed.

Option 3:

Tax administrations would change their administrative practice by "freezing" interest charges during the MAP discussions. This would mean that the MNE Group would not receive interests on its overpaid taxes by one tax administration, and the interest would not be paid on its additional taxes during the MAP discussions period.

Other issues and related options:

Tax administrations could adopt a uniform approach valid for all cases or choose one of the three options on a case by case approach in order to take into consideration the specifics of the case or the legal provisions prevailing in the other MS.

Tax administrations are recommended to take appropriate action to avoid the application of interest charges during the MAP negotiations. However as these interests are always related to double taxations cases Tax administrations could also examine on a case by case whether it is fair and relevant to charge or reimburse interests for the period previous to the MAP request.